

INITIAL STATEMENT OF REASONS/NON-CONTROLLING SUMMARY

Amendment of Property Tax Rule 462.500

Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings

Specific Purpose

Rule 462.500 interprets, implements and makes specific Revenue and Taxation Code section 68, which provides that the term “change in ownership” does not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced by eminent domain proceedings, acquisition by a public entity, or governmental action resulting in a judgment of inverse condemnation. Replacement real property is deemed comparable to the property taken if it is similar in size, utility, and function and is comparable only to the extent that the full cash value of the replacement property does not exceed 120 percent of the award or purchase price paid for the property taken. Section 68 implements article XIII A, section 2, subdivision (d), of the California Constitution.

Rule 462.500 limits property tax relief to real property deemed similar to the property taken “in size, utility, and function.” Two properties are similar in function if they are subject to similar government restrictions, such as zoning. The rule treats the criteria of size and utility as interrelated and associated with value and deems two properties similar in size and utility only to the extent the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single-family residential and duplex, commercial, industrial, etc.).

Pursuant to Government Code section 11340.6, a taxpayer representative requested the Board amend Rule 462.500 to replace the existing requirements for comparability with requirements based on the same or similar concepts as those utilized in the developed body of law under Internal Revenue Code sections 1031 and 1033 and the accompanying Treasury Regulations to define “like-kind” property. The Board determined that the language of the Constitution and the statute is vague and that existing guidance is limited, specifically with respect to the meaning of the terms “size, utility, and function.” The definitions set forth in the amended rule more accurately reflect the intent of the Constitution and the statute, and provide consistency in the income and property tax relief provisions for property taken by governmental action or eminent domain proceedings.

Consistent with the Board’s determination, amended Rule 462.500 defines “comparability” to provide that size is associated with value, not physical characteristics, and that two properties are similar in size if the full cash value of the replacement property does not exceed 120 percent of the award or purchase price paid for the property taken. The amended rule provides that function and utility are associated with use and sets forth three specific categories of use: Category A – single-family residence or duplex; Category B – commercial, investment, income, or vacant property; and Category C – agricultural property. The amended rule also provides clarifying definitions for “displaced,” “real property,” and “adjusted base year value,” as well as adding an

additional date after which replacement property must be acquired and adding clarifying language and an example regarding base year value to be transferred.

Factual Basis

The rule interprets constitutional and statutory provisions which provide property tax relief upon the acquisition of real property to replace comparable real property taken by governmental action or eminent domain proceedings. Rule 462.500, as adopted and previously amended, limited property tax relief to replacement property deemed similar to the property taken “in size, utility, and function.” The rule looked to the use or intended use of the property to determine the similarity of the size and utility of two properties, while requiring two properties similar in function to be subject to similar government restrictions, such as zoning.

In order to simplify the application of Rule 462.500 and to provide consistency between the income tax relief provisions and the property tax relief provisions for property owners acquiring real property to replace property taken by governmental action or eminent domain proceedings, the Board proposes in Rule 462.500 to redefine “size, utility, and function” as they relate to the determination of comparability of two properties. The amended rule will associate size with value, not physical characteristics, while associating utility and function with use. The rule further delineates three specific categories of use and provides additional examples to illustrate the categories of utility and function. When the proposed rule as amended becomes effective, it should more accurately reflect the constitutional intent and provide consistency between the various tax relief provisions for property owners affected by governmental action or eminent domain proceedings.